

FORECASTS 1981

HOPE SPRINGS ETERNAL

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The views and opinions set forth in this article are those of the various forecasters. No agreement or endorsement by this Bank is implied.

Forecasts for 1981 generally call for slow real growth, continued inflation, high interest rates, and continued high unemployment. Yet the tone and feel of this year's forecasts are not pure gloom and doom, but rather gloom tempered with a cautious expectation that better days may be coming. The hint of optimism generally stems from assumptions that economic policy for 1981 will: (1) promote a resurgence of business investment spending in late 1981 and 1982; (2) foster more moderate and stable rates of money growth in 1981; (3) reduce the rate of growth of government spending; (4) and reverse a fraction of the substantial, previously legislated, tax increases for 1981 and beyond.

The forecasters expect domestic fuel prices to rise further in 1981, partially as a result of the continuing Iran-Iraq conflict and partially as a result of continuing decontrol of domestic crude oil, gasoline, and natural gas. They also expect food prices to rise, primarily because of last year's drought in parts of the United States and poor grain harvests internationally.

Additional uncertainties cloud the 1981 outlook, including the prospects for domestic automobile production and the possible ripple effects of a failure of a major automobile company. The forecasters, however, seem to think that home financing costs will decline to some extent in the second half of the year and that the depressed construction and real estate industry will begin to recover. The second half optimism, however, is dependent upon the assumption that taxes will be reduced from the very high levels of early 1981, although few forecasters expect a tax cut substantial enough to lower taxes to 1980 levels. Most forecasters also note that increasing and/or wildly fluctuating rates of growth of the money supply in 1981 would do serious damage to the prospects for the economy in the second half of 1981

and in 1982. Many, (somewhat surprisingly, given recent experience) think that policymakers will stabilize money growth and hold it to moderate levels.

Last year, the median forecast for real GNP growth, —1.3 percent, was close to the actual growth rate, —0.1 percent. The quarter-by-quarter path was somewhat different from that forecast because the forecasters expected two quarters of negative real GNP growth in the first half, followed by a modest recovery in the second half. None of them forecast so sharp a drop in real GNP as that actually registered in the second quarter of 1980, 9.9 percent. However, given that the consensus forecast was for annual rates of —4.6 percent real growth in the first quarter and —2.8 percent in the second, they were predicting that real GNP would register a \$1,463.5 billion level (from the revised fourth quarter 1979 GNP) in the second quarter, 1.8 percent below the fourth quarter of 1979. The actual level reached was \$1,463.3 billion. Thus, even though none of last year's forecasters anticipated the credit control program imposed last March, their predictions turned out to be quite close to the mark.

The forecasters expected the rate of inflation to decline throughout the year, which it did not, but they underpredicted the rate of inflation by less than had been their norm in past years. All-in-all, last year's forecasters have to be given high marks for their prescience.

This article attempts to convey the general tone and pattern of some forty forecasts received by the Research Department of this Bank. Not all of these forecasts are comprehensive, and some incorporate estimates of future behavior of only a few key economic indicators. Some are made in terms of annual averages while others are made on a quarter-by-quarter basis, and a summary statistic drawn from one of these groups may differ from that of another. Moreover, the individual forecasts are based on varying assumptions and this should be taken into account in interpreting the summary statistics.

This Bank also publishes the booklet Business Forecasts 1981, which is a compilation of representative business forecasts with names and details of the various estimates. No summary article can ever be as informative as the actual forecasts themselves. Interested readers can examine the individual forecasts in more detail in Business Forecasts 1981.

1980 FORECASTS IN PERSPECTIVE

The Department of Commerce published a major revision of the National Income and Product Accounts in December 1980. The forecasts for 1980, of course, were based upon information that was available to the forecasters in late 1979 and early 1980, so they were based upon the old GNP series. As a result, it is difficult to evaluate the forecasts fairly. *This article uses the revised National Income and Product Accounts numbers. The reported 1980 forecasts are reconstructed by applying the forecast percentage changes to the revised 1979 National Income and Product statistics.*

The median forecast published in last year's January/February *Economic Review* predicted 1980 current dollar GNP to increase 7.3 percent over 1979. Individual forecasts of this growth rate ranged from 5.3 percent to 9.2 percent. Using the revised 1979 GNP total of \$2,413.9 billion, the median forecast for 1980 GNP would have been \$2,590.1 billion and the range from \$2,541.8 billion to \$2,636.0 billion. Increasing prices were expected to account for 8.7 percent of the gain in GNP, so GNP measured in constant dollars, or real GNP, was expected to fall 1.3 percent.

Current estimates by the U. S. Department of Commerce indicate that GNP in 1980 actually increased 8.9 percent. Prices, as measured by the implicit deflator for GNP, however, increased 9.0 percent. As a result, preliminary estimates call for a 0.1 percent decline in real GNP—close to the 1.3 percent decline predicted last year. The forecasters expected the unemployment rate to average 7.6 percent for the year. At present, estimates indicate an average of 7.2 percent.

As with the aggregate GNP figure, the forecasters also underpredicted the components of GNP. Most of the underprediction can probably be attributed to underestimating the rate of inflation.

Personal consumption spending was forecast to increase 9.1 percent, but it actually rose 10.6 percent. Consumer purchases of durable goods, predicted to increase 1.2 percent, actually fell 0.3 percent. Pur-

chases of nondurables were estimated to increase 9.0 percent, whereas the actual rate of increase was 12.0 percent. Consumption spending for services was forecast to increase 11.1 percent. The actual 13.6 percent increase was considerably higher than the estimate. Consumer spending for services was the most predictable component of consumption spending in past years. However, in the last two years forecasters have underestimated the rate of increase in services prices rather substantially.

The forecasters expected a rather sharp 2.3 percent decline in gross private domestic investment. Investment spending in fact declined substantially more, 4.6 percent. The largest source of error in the investment account was residential construction. The prediction for residential construction was for a fall of 7.0 percent, but the actual fall was considerably more, 11.4 percent. The median forecast for business fixed investment was an increase of 5.7 percent, close to the actual 5.4 percent rise.

The forecasts of the last major component of GNP, government purchases of goods and services, centered around a rate of increase of 10.7 percent. Actual government spending is now thought to have risen 12.9 percent. Thus, the major components of GNP were underestimated in last year's median forecast.

The forecasts for 1980 predicted industrial production fairly accurately. The index of industrial production fell 3.7 percent, slightly more than the predicted 3.6 percent fall.

Before-tax corporate profits were predicted to fall 7.6 percent, but the prediction was based upon the corporate profits as defined by the Commerce Department prior to the December 1980 revision. The revised corporate profits figures include retained earnings of foreign branches of domestic corporations, and are thus substantially different from previous estimates. As a result, it is unfair to evaluate the 1980 forecasts against the revised data.

Most forecasters underestimated the rise in the consumer price index by an even larger margin than the implicit price deflator. On average, consumer prices were expected to rise 10.8 percent, but current figures indicate a rise of 13.4 percent.

The median quarterly forecast for 1980 had current dollar GNP rising 4.9 percent in the first quarter, 5.4 percent in the second quarter, 8.6 percent in the third quarter, and 10.4 percent in the fourth, stated at annual rates. The realized quarterly increases, at annual rates, were 12.6 percent, —1.1 percent, 11.8 percent, and 16.7 percent. For real

GNP, the median forecast called for annual rates of increase of -4.6 percent, -2.8 percent, 1.4 percent, and 3.1 percent for the four quarters, respectively. The realized increases for the first three quarters, were 3.1 percent, -9.9 percent, and 2.4 percent, while the preliminary number for the fourth quarter is now placed at 5.0 percent.

The forecasters, then, exhibited considerably less prescience about the quarterly path of the economy than they did about real GNP for the year as a whole. They expected a two quarter decline in GNP

growth followed by a recovery, with the sharpest decline coming in the first quarter of the year. Instead, the economy experienced negative GNP growth only in the second quarter of the year. The decline in the second quarter, however, was very large.

The unemployment rate was expected to average 6.8 percent in the first quarter and to rise to an average of 7.8 percent by the fourth quarter. Instead, the unemployment rate was 7.5 percent in the fourth quarter. The path of unemployment rate movements

RESULTS FOR 1980 AND TYPICAL FORECASTS FOR 1981

| | Unit or Base | Preliminary 1980* | Forecast 1981** | Percentage Change | |
|---|-----------------|----------------------|--------------------|----------------------|---------------|
| | | | | 1980/ 1979 | 1981/ 1980 |
| Gross national product | \$ billions | 2,628.8 | 2,910.1 | 8.9 | 10.7 |
| Personal consumption expenditures | \$ billions | 1,671.1 | 1,856.6 | 10.6 | 11.1 |
| Durables | \$ billions | 211.6 | 234.7 | -0.3 | 10.9 |
| Nondurables | \$ billions | 674.3 | 739.0 | 12.0 | 9.6 |
| Services | \$ billions | 785.3 | 882.7 | 12.8 | 12.4 |
| Gross private domestic investment | \$ billions | 396.8 | 436.1 | -4.6 | 9.9 |
| Business fixed | \$ billions | 294.7 | 309.7 | 5.4 | 5.1 |
| Residential structures | \$ billions | 105.1 | 117.8 | -11.4 | 12.1 |
| Change in business inventories | \$ billions | -3.0 | 9.0 | — | — |
| Government purchases | \$ billions | 534.8 | 588.8 | 12.9 | 10.1 |
| Net exports | \$ billions | 26.1 | † | — | † |
| Gross national product (1972 dollars) | \$ billions | 1,481.8 | 1,498.1 | -0.1 | 1.1 |
| Plant and equipment expenditures | \$ billions | 294.3e | 318.4e | 8.8 | 8.2 |
| Corporate profits before taxes | \$ billions | NA | † | NA | † |
| Private housing starts | millions | 1.29 | 1.46 | -26.0 | 13.5 |
| Automobile sales (domestic) | millions | 6.55 | 6.90 | -20.3 | 5.3 |
| Rate of unemployment | percent | 7.1 | 7.9 | — | — |
| Industrial production index | 1967=100 | 147.0 | 149.2 | -3.4 | 1.5 |
| Consumer price index | 1967=100 | 246.8 | 273.9 | 13.5 | 11.0 |
| Implicit price deflator | 1972=100 | 177.40 | 194.25 | 9.0 | 9.5 |

* Data available as of January 1981.

** Figures are constructed from the median percentage change forecast, based upon the revised 1980 preliminary GNP estimates.

e Estimated

NA Not available.

† Net exports and corporate profits before taxes were revised so radically in the December 1980 benchmark revision that the median forecasts, \$5.0 billion and \$239.5 billion, respectively, are not comparable.

was somewhat different from the gradual upward path forecast, because the unemployment rate rose to 7.5 percent in the second quarter and remained there for the remainder of the year.

1981 FORECASTS IN BRIEF

Gross National Product The forecasts received by this Bank were all prepared before the release on December 23, 1980, of the National Income and Product Account revisions. In most cases, forecasts for the 1981 levels of the GNP accounts were reconstructed by applying the median percentage change forecast to the revised 1980 aggregates. For some series like corporate profits and net exports, where definitional changes made such reconstructions inappropriate, the forecasts were not changed and should be compared to unrevised 1980 data.

Forecasts for 1981 current dollar GNP center around \$2,910 billion. This median forecast indicates an approximate 10.7 percent yearly gain, more than the 8.9 percent increase apparently registered in 1980. Estimates for increases in 1981 current dollar GNP range from 7.9 percent to 11.5 percent. Prices, as measured by the implicit deflator for GNP, are expected to increase 9.5 percent, slightly more than the 9.0 percent rate of increase registered last year. Real GNP is projected to rise 1.1 percent, compared to a 0.1 percent decline in 1980.

The median quarterly estimate indicates a slow improvement in real GNP growth throughout the year, following a stagnant first quarter. It calls for real GNP, measured at seasonally adjusted annual rates, to remain constant in the first quarter of 1980, to increase 2.4 percent in the second, 3.2 percent in the third quarter, and 4.0 percent in the fourth.

Personal consumption expenditures are expected to total \$1,857 billion for 1981, up 11.1 percent from 1980. The predictions for rates of growth of consumption spending range from 7.5 percent to 12.0 percent. Forecasters estimate that expenditures for durable goods will rise 10.9 percent for the year, while expenditures for nondurables and services are projected to advance 9.6 percent and 12.4 percent, respectively. Much of the improvement in durable goods expenditures is expected to stem from an improvement in domestic automobile sales from the depressed 1980 level.

Government purchases of goods and services are projected to total \$589 billion. This estimate repre-

sents a 10.1 percent increase over 1980, somewhat less than the 12.9 percent gain of the previous year. The 1980 forecasts for increases in government purchases range from 8.9 percent to 11.7 percent.

Gross private domestic investment is expected to rise by 9.9 percent in 1981, reversing the 4.6 percent fall in 1980. Inventory investment is expected to improve over 1980. Residential construction is also expected to improve in 1981, rising 12.1 percent above 1980's depressed level. Even so, it will not be much improved over 1979. Business fixed investment spending will be sluggish (particularly in the first half of the year) if the median forecast is correct. That component is expected to register a 5.1 percent gain compared to 5.4 percent last year. The array of forecasts for business fixed investment, however, is quite broad this year, from -5.3 percent to +14.4 percent. Expectations for residential construction range from increases of 0.8 percent to 25.7 percent. Forecasts for change in business inventories range from -\$6.0 billion to +\$15.0 billion, with a \$9 billion median.

Industrial Production The typical forecast for the Federal Reserve index of industrial production (1967=100) in 1981 is 149.2, an increase of 1.5 percent over the 1980 average. This prediction again reflects the slow growth expected in 1981.

Housing The construction industry is expected to recover only moderately from the effects of high mortgage rates and rising construction materials costs. Activity in this sector is expected to improve only 13.5 percent from the slow 1980 pace. Private housing starts, which totaled almost 2 million units in 1978, totaled only 1.3 million units in 1980 and are expected to total only 1.5 million units in 1981. Forecasters expect little recovery in construction until the second half of the year when credit is expected to be somewhat more available and mortgage rates are expected to be somewhat lower.

Corporate Profits The forecasters, predicting corporate profits on an unrevised basis, expect pretax corporate profits to improve this year. The most pessimistic forecaster expects corporate profits to rise only 0.9 percent. The most optimistic predicts an 11.9 percent rise. The median forecast calls for a modest increase in pretax profits of 4.6 percent. Hence, corporate profits are expected to reflect the slowly improving economy, but they are expected to rise substantially less than they normally do in years of recovery.

**TYPICAL* QUARTERLY FORECASTS
FOR 1981****

Percentage Quarter-to-Quarter Annual Rates
Unless Otherwise Indicated

| | Forecast 1981 | | | |
|---------------------------------------|---------------|------|------|------|
| | I | II | III | IV |
| Gross national product | 8.9 | 11.4 | 13.0 | 14.0 |
| Personal consumption expenditures | 10.4 | 12.2 | 12.7 | 12.3 |
| Durables | 5.7 | 14.1 | 10.7 | 13.7 |
| Nondurables | 8.7 | 11.9 | 11.9 | 11.6 |
| Services | 12.1 | 13.9 | 13.8 | 14.2 |
| Gross private domestic investment | 1.6 | 15.6 | 15.8 | 30.4 |
| Business fixed investment | 6.1 | 9.6 | 14.0 | 15.6 |
| Residential construction | 8.9 | 19.3 | 29.1 | 35.4 |
| Change of business inventories† | 3.0 | 6.1 | 9.0 | 12.0 |
| Government purchases | 9.1 | 8.9 | 11.1 | 11.3 |
| Net exports‡ | 8.8 | 4.3 | -2.8 | -7.0 |
| Gross national product (1972 dollars) | 0.0 | 2.4 | 3.2 | 4.0 |
| Corporate profits before taxes | -5.7 | 8.8 | 10.3 | 18.2 |
| Private housing starts | -49.1 | 0.0 | 31.6 | 33.9 |
| Industrial production index | 0.0 | 3.2 | 4.8 | 6.8 |
| Rate of unemployment‡ | 7.9 | 8.0 | 7.9 | 7.6 |
| Consumer price index | 12.6 | 11.7 | 9.4 | 9.2 |
| GNP implicit deflator | 9.5 | 8.5 | 8.7 | 9.7 |

* The "typical" forecast was derived by figuring the cumulative percentage change for each quarter forecast over each forecaster's fourth quarter 1980 estimate. The "typical" forecast for each quarter was drawn from the median of these cumulative estimates. Only then was the quarter-by-quarter growth path derived.

** All forecasts were prepared prior to release of the benchmark revisions of the National Income and Product Accounts.

† Levels, billions of dollars.

‡ Levels, percent.

Unemployment Most forecasters are predicting an increase in the rate of unemployment during 1981. The typical forecast for the year's average is around 7.9 percent. Considering that the unemployment rate at year-end 1980 stood at 7.4 percent, the 7.9 percent prediction for 1981 indicates that the unemployment

rate is expected to move up relatively little during the course of the year. The quarterly median forecast puts the unemployment rate at 7.9 percent and 7.6 percent in the third and fourth quarters, respectively.

Prices This year's forecast indicates that the rate of price increase will remain at about last year's rate. The implicit GNP deflator, which rose 9.0 percent in 1980, is expected to increase 9.5 percent in 1981. The consumer price index is expected to rise 11.0 percent. Forecasts for increases in the implicit deflator range from 8.0 percent to 10.1 percent, while forecasted increases in the consumer price index range between 8.2 percent and 12.1 percent. Much of the variance in the price forecasts depends on the forecasters' expectations about oil and food prices.

Net Exports The nation's trade position, measured on a National Income Accounts basis, was predicted to remain at the \$5 billion level in 1981, showing little change from an estimated *unrevised* net exports total for 1980. There is little consensus in the forecasts, however. They varied widely, between -\$13.0 billion and +\$16.0 billion.

Quarter-by-Quarter Forecasts Twelve forecasters who made quarter-by-quarter forecasts for 1980 were surveyed. As shown in the accompanying table, the forecasters (on average) expect real GNP in the second quarter of 1981 to be only 0.6 percent higher than it was in the fourth quarter of 1980. By the fourth quarter of 1981, however, real GNP should be 2.4 percent higher than it was in the fourth quarter of 1980, if the median forecast is correct. Translated into quarter-by-quarter compounded annual rates, the median expectation is for 0.0 percent real growth in the first quarter, 2.4 percent real growth in the second quarter, 3.2 percent growth in the third, and 4.0 percent growth in the fourth quarter.

There is considerable variation among the forecasters, however. The forecasts for fourth quarter 1981 over fourth quarter 1980 ranged from a low of 1.1 percent to a high of 3.0 percent. While almost half of the quarterly forecasts predict negative growth in real GNP in the first quarter of 1981, only one forecaster expects more than one quarter of negative growth. (That forecaster expects real GNP to fall in the first two quarters of the year, by annual rates of 0.8 percent in the first quarter and 2.4 percent in the second.) Excluding that one forecaster, all of the others who made quarter-by-quarter

predictions expect the first quarter of 1981 to show the slowest growth with continued improvement registered in each of the following quarters.

If the median forecasts are realized, the unemployment rate will rise to 7.9 percent in the first quarter of 1981 and fall to 7.6 percent by the fourth quarter. The unemployment rate forecasts for the fourth quarter of 1981 ranged from 7.2 percent to 8.1 percent.

On average, the forecasters expect the quarterly rate of increase in the price of items included in GNP to fluctuate between 8.5 percent and 9.7 percent in 1981. The median forecasts were for increases of 9.5 percent, 8.5 percent, 8.7 percent, and 9.7 percent for the four quarters, measured at seasonally adjusted annual rates. Forecasts ranged from 7.4 per-

cent to 10.4 percent in the first quarter, 7.3 percent to 10.1 percent in the second, 7.1 percent to 9.5 percent in the third, and 7.3 percent to 9.8 percent in the last quarter of 1981.

Regarding components of GNP, consumer spending for durables is expected to show considerable improvement in the last three quarters of 1981, after a slow first quarter. Business fixed investment spending is expected to pick up considerably in the second half of the year. Residential construction spending, after a poor first quarter, is expected to recover appreciably. The number of private housing starts follows this same pattern but with sharper swings. The recovery in housing starts is expected to get underway in the second half of the year, following a miserable first half.